

**SANITIZED DEC. – 03-283 U – BY – GEORGE V. PIPER – SUBMITTED FOR
DECISION – 11/21/03 – ISSUED – 02/06/04**

SYNOPSIS

PURCHASERS' USE TAX – ROYALTY FEES NOT TAXABLE – Royalty fees paid by the Petitioner in order to retain the commercial benefit of the franchisor's trademark and the corresponding goodwill, are in no respect consideration for taxable services rendered to the Petitioner by the franchisor.

FINAL DECISION

The Director of the Field Auditing Division of the Commissioner's Office issued a purchasers' use tax assessment against the Petitioner. This assessment was issued pursuant to the authorization of the Commissioner, under the provisions of Chapter 11, Articles 10 and 15A of the West Virginia Code. This assessment was for the period of February 1, 1999 through June 30, 2002, for tax, interest, through December 31, 2002, and no additions to tax.

Written notice of this assessment was served on the Petitioner.

Thereafter, by mail postmarked April 25, 2003, the Petitioner timely filed with this tribunal, the West Virginia Office of Tax Appeals, a petition for reassessment. See W. Va. Code § 11-10A-8(1) [2002].

FINDINGS OF FACT

1. Petitioner is a corporation having its principal office in another state.
2. Petitioner is a franchisee and during the audit period, Petitioner operated eleven (11) restaurants in West Virginia.
3. Franchisor owns and operates, or licenses, a national chain of casual dining establishments selling food and beverages.

4. To memorialize the franchisor/franchisee relationship between them, Franchisor and Petitioner entered into the standard form franchise agreement (the "Agreement").
5. The Agreement was executed for each of the locations that Petitioner operates in West Virginia
6. For every year in which Petitioner operates as a franchisee of Franchisor, it must execute the Agreement with Franchisor.
7. During the Audit Period, the Agreement remained identical in form and in substance.
8. Pursuant to Section 9.1 of the Agreement, Petitioner paid to Franchisor a one-time fee (the "Initial Franchise Fee") for each of the locations.
9. As additional consideration for the grant of the franchise to it, Petitioner is also required to pay to Franchisor an amount not to exceed four percent (4%) of each calendar month's gross sales at each location (the "Royalty Fee").
10. In terms of construction, maintenance, and renovation with respect to the improvements and equipment at locations, all costs are borne by Petitioner, and Franchisor is in no way responsible for either the coordination of or payment of such costs.
11. To fulfill its additional obligation under the Agreement to spend a certain percentage of its annual sales on marketing and advertising, Petitioner contracts with an advertising company that coordinates all local advertising, including radio and television ads.

12. Although Franchisor provides Petitioner with a list of approved food vendors, Petitioner alone negotiates its contracts with those vendors, develops delivery schedules and arranges the payment terms thereunder.

13. Regarding the menu selection for use by the Petitioner, it arranges for the menu selection, menu design and payment therefor on a bi-annual basis.

14. Petitioner is responsible for all costs and arrangements associated with the training of employees at the locations.

15. In order to maintain the value of the Franchisor's trade name, Petitioner is contractually required under the Agreement to maintain certain standards of conformity for each of the locations, including remodeling specifications, the costs for which are borne entirely by Petitioner and are separate and apart from the Royalty Fee.

16. Petitioner makes all of its own personnel decisions and follows its own employee policies and procedures.

17. Petitioner does not, as a practical matter, use Franchisor's trainers to train its employees even at the inception of operations at any new location.

18. Petitioner does send its managers to training seminars provided by Franchisor; however, Petitioner pays the registration fee, hotel costs and meal and travel expenses for such training.

19. In order to ensure compliance with Franchisor's standards, Franchisor periodically performs inspections of the locations.

20. Several times each year, Franchisor publishes a Period Information Guide, which sets forth that period's featured menu items and details procedures for the preparation and marketing of that item.

21. Although Petitioner receives one complimentary copy of the guide, all other copies are procured by and paid for by Petitioner.

22. The separate, third-party vendor that prints the guide also prints human resource materials and marketing materials for Petitioner at Petitioner's sole cost and expense.

23. Petitioner contracted with, at its sole expense, a vendor to perform configuration services on its computer system, including setting up and maintaining a website for Petitioner and performing various data processing services.

24. To assist Petitioner with problems related to accounting, (e.g., credit card sales) Franchisor provides a "help desk" by which Petitioner may ask finance-related questions in return for a quarterly fee, which is billed and paid wholly separate and apart from the Royalty Fee.

25. None of the costs and services that Petitioner incurs for the construction and renovation of restaurants, advertising, food procurement and menu design, data processing or personnel are included in the Royalty Fee and for financial purposes, are classified separately in the appropriate expense category.

26. Petitioner acknowledges that the Royalty Fee is intended to encompass the right to use its intangible trademark and does not include a service component. (Petitioner's Exhibit No. 13).

27. On or about March 14, 2003, Petitioner remitted an amount to the Tax Commissioner which represented the amount of tax and interest with respect to items that it did not contest, leaving the amount in controversy, including interest.

DISCUSSION

The sole issue to be determined is whether the Petitioner has shown that the royalty fees paid by Petitioner to its Franchisor are solely to retain the commercial benefit of the franchised trademark and the goodwill attributable to it and are in no respect consideration for taxable services rendered to it by the Franchisor.

As established in the record, Petitioner does arrange for and pay for all construction, maintenance, and renovation with respect to the improvements and equipment at each of its locations. (Petitioner's Exhibit No. 1). Petitioner is the one that contracts with an advertising company that coordinates all local advertising, including radio and television ads. (Petitioner's Exhibit No. 12). Moreover, Petitioner arranges for its own menu selection, menu design and payment therefore on a bi-annual basis. (Petitioner's Exhibit Nos. 8-9).

Further, Petitioner is responsible for all costs and arrangements associated with the training of employees at each of its locations, as well as all remodeling costs required to be incurred in order to maintain the value of the Franchisor's trade name which are borne entirely by Petitioner and are paid separate and apart from the

Royalty Fee. Petitioner makes all of its own personnel decisions and follows its own employee policies and procedures and does not, as a practical matter, use Franchisor's trainers to train its employees even at the inception of operations at any new location. Although Petitioner has sent its managers to training seminars provided by Franchisor, Petitioner pays the registration fee, hotel costs and meal and travel expenses for all such training. (Petitioner's Exhibit No. 6).

Petitioner does in fact procure a separate, third-party vendor that prints the period information guide, as well as human resource materials and marketing materials for Petitioner, at Petitioner's sole cost and expense. (Exhibit No. 11). Petitioner also contracted, at its sole expense, with a vendor to perform configuration services on its computer system, including setting up and maintaining a website for Petitioner and performing various data processing services. (Petitioner's Exhibit No. 5).

Finally, none of the costs and services that Petitioner incurs for the construction and renovation of restaurants, advertising, food procurement and menu design, data processing or personnel are included in the Royalty Fee and for financial purposes, are classified separately in the appropriate expense category.

In his reply brief Commissioner's counsel emphasizes those portions of the franchise agreement which require the franchisor to advise and consult with Petitioner periodically; to provide a "help desk" by which Petitioner may ask finance-related questions for a separate fee; to make its training personnel available prior to the initial opening; to periodically develop and test new menu items and to make its

operations training course available to Petitioner's general manager, kitchen manager, and other managerial personnel.

Although Commissioner's counsel argues that said provisions represent taxable services rendered, this tribunal finds that the same are in actuality requirements or standards which the franchisor seeks to impose upon its franchisees to ensure the proper operation of the restaurants. Franchisees, including the Petitioner, are to bear the necessary costs and are responsible to ensure that such standards are met, e. g. human resources, advertising, data processing and the like, and these items are clearly separate and apart from the royalty fees which it pays.

CONCLUSIONS OF LAW

Based upon all of the above it is **DETERMINED** that:

1. In a hearing before the West Virginia Office of Tax Appeals on a petition for reassessment, the burden of proof is upon the petitioner-taxpayer to show that the assessment is incorrect and contrary to law, in whole or in part. See W. Va. Code § 11-10A-10(e) [2002] and 121 C.S.R. 1, § 63.1 (Apr. 20, 2003).

2. The Petitioner-taxpayer in this matter has carried its burden of proof with respect to its argument that payments made to its franchisor were solely royalty payments and that no portion thereof represents payments made for services rendered to the Petitioner by the franchisor.

DISPOSITION

WHEREFORE, it is the **FINAL DECISION** of the **WEST VIRGINIA OFFICE OF TAX APPEALS** that the purchasers' use tax assessment issued against the

Petitioner for the period of February 1, 1999 through June 30, 2002 should be and is hereby **MODIFIED** in accordance with the above Conclusions of Law for a total revised tax liability.

Because the Petitioner has previously remitted the full amount, no purchasers' use tax remains due to the State Tax Commissioner of West Virginia.